87-903

No.

Supreme Court, U.S.
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JOSEPH F. SPANIOL, JR.
CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1987

OTTIS B. CROCKER, JR., *et al.*,
Petitioner,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

and

W. P. MCMULLAN, *et al.*,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Whether diverse state laws or federal law should be used to determine standing of a "person injured" under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1962 et seq.?

LIST OF PARTIES

The parties to the proceeding are as follows:

Ottis B. Crocker, Jr. and Kay Embry Crocker, individually and on behalf of all other similarly situated shareholders of the Mississippi Bank, Petitioners/Plaintiffs below.

Federal Deposit Insurance Corporation in its corporate capacity, Respondent/Plaintiff-Intervenor.

W. P. McMullan, Jr., Pat C. Clancy, Joe N. Denson, Mitchell L. McMullen, John Baxter Burns, III, Terrell E. Wise and John Does, Defendants below.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

OPINIONS BELOW

The opinion of the United States District Court for the Southern District of Mississippi is published at 623 F.Supp. 963 (N.D.Miss. 1986). A copy of that opinion is included in the appendix. App. 15. The panel decision of the United States Court of Appeals for the Fifth Circuit is published at 826 F.2d 346 (5th Cir. 1987). The panel opinion is included in the appendix. App. 1.

JURISDICTION

The judgment of the Court of Appeals was entered on September 2, 1987. The jurisdiction of this court is invoked under 28 U.S.C. § 1254(1). Petitioner further

asserts that this Court should grant certiorari to review the federal appeals court decision in that it seems to be in conflict with the direction taken or decisions made on this issue in other federal courts of appeals. S.Ct.R. 17.1(a)(b).

STATUTORY PROVISIONS INVOLVED

18 U.S.C. § 1964(c) provides in pertinent part:

> Any person injured in his business or property by reason of a violation of § 1962 of this chapter [18 U.S.C. § 1962] may sue therefor in any appropriate United States District Court and shall recover threefold the damages he sustains in the cost of this suit including a reasonable attorney's fee.

STATEMENT OF THE CASE

A. Facts

The petitioners, Ottis B. and Kay E. Crocker (Crockers), and the class they represent, minority shareholders of The Mississippi Bank ("Bank"), initiated an action against former officers and directors of the "Bank" in the United States District Court for the Southern District of Mississippi. Federal jurisdiction was predicated on alleged violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §§ 1962-68. Petitioners also alleged common law claims including misrepresentations and breaches of fiduciary duties.

The Federal Deposit Insurance Corporation (FDIC), which had taken possession of the assets of the "Bank," filed a motion to intervene and moved to dismiss under Fed.R.Civ.P. 12(b)(6). The FDIC contended that the Crockers lacked standing because their claims were derivative and belonged to the "Bank"/FDIC, not to the minority shareholders in their individual capacities. The decision of the district judge denied the FDIC's motion

to dismiss. After the district court certified the issue pursuant to Fed.R.Civ.P. 54(b), the FDIC appealed.

A panel of the Court of Appeals for the Fifth Circuit reversed and rendered the district court judge's judgment, holding that state law determines whether plaintiffs have been injured in their property by reason of RICO violations so as to confer federal jurisdiction under 18 U.S.C. § 1964(c). The court of appeals discussed Mississippi law and found that contrary to the district court's ruling, Mississippi law would not provide a remedy to the minority stockholders. The panel disagreed with the Mississippi district court judge's decision that the injury was individual to the plaintiffs, holding instead that the claim was not nonderivative. The court of appeals concluded that since the Crockers had no "cognizable individual injury" under Mississippi law, their claim was derivative, and they lacked standing under RICO.

REASONS FOR GRANTING THE WRIT

I. The Decisions of the Courts of Appeals as to Whether State Law Should Govern Standing in a RICO Claim Are Apparently in Conflict.

When jurisdiction is premised under RICO, should the law of a partciular state determine whether the injury is sufficient to support the "injury in his business or property" required by 18 U.S.C. § 1964(c)? The general rule is that when a federal statute creates a cause of action, federal law—interpreting federal policies—not state law, controls. *Burks v. Lasker*, 441 U.S. 471 (1979); *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964).

The Seventh Circuit in *Schact v. Brown*, 711 F.2d 1343, 1347 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983) has indicated that when there is a claim under RICO, the analysis of standing should be governed by federal policy considerations in enforcing federal laws.

See also, O'Donnell v. Kusper, 602 F.Supp. 619 (N.D. Ill. 1985). The Courts of Appeals for the Fifth, Sixth and Second Circuits have held that the laws of a particular state determine whether a plaintiff has been injured for purposes of standing under RICO. *Gaff v. FDIC*, 814 F.2d 311 (6th Cir. 1987); *Warren v. Manufacturers National Bank of Detroit*, 759 F.2d 542 (6th Cir. 1985); and *Rand v. Anaconda-Ericsson, Inc.*, 794 F.2d 843 (2d Cir. 1986).

It is important that standing under 18 U.S.C. § 1964 (c) be uniform throughout the United States. Relying on the various states' laws to determine the nature and extent of an "injury in business or property" would lead to a lack of uniformity.

The general rule in most jurisdictions in the United States is that "a stockholder of a corporation has no personal or individual right of action against third persons for damages that result indirectly to the stockholder because of an injury to the corporation." *Twohy v. First National Bank of Chicago*, 758 F.2d 1185, 1194 (7th Cir. 1985). Many jurisdictions subscribe to this general rule. See *Cowin v. Bressler*, 741 F.2d 410, 414 n.6 (D.C. Cir. 1984) citing jurisdictions that subscribe to the general rule. There are exceptions. *Schaffer v. Universal Rundle Corp.*, 397 F.2d 893 (5th Cir. 1968); *Johnson v. American General Insurance Co.*, 296 F.Supp. 802 (D.D.C. 1969); *Yanow v. Teal Industries Inc.*, 422 A.2d 311 (Conn. 1979).

When the duty is a fiduciary one, such as here and in *Johnson v. American General Insurance Co., supra*, there is a greater likelihood of confusion. Some states have adopted a statutory definition of the duty owed by officers and directors to corporations. Others have not. In those states which have adopted a statutory scheme, the duties for officers and directors is often very different. *Compare* Va. Code Ann. § 13.1-690 (Supp. 1985) *with* Miss. Code

Ann. § 79-4-8.30 (Supp. 1987). For purposes of RICO standing state law should not be a factor.

II. The Limitations Some Circuits Have Placed on RICO Claims Thwart the Congressional Purpose in That They Fail to "Liberally Construe the Act 'to Effect Its Remedial Purposes'."

The so-called "prudential" limitation on standing that was apparently the basis of the panel decision in the Court of Appeals for the Fifth Circuit was developed to prevent multiplicity of actions by numerous shareholders and thereby protect corporate creditors. *See generally*, 12(B) W. Fletcher, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, §§ 5907-5914 (rev. perm. ed. 1984). Although courts are bound by constitutional standing limitations, *Gladstone v. Realtors*, 441 U.S. 91 (1979); *Trafficante v. Metropolitan Life Insurance Co.*, 409 U.S. 205 (1972), they are not absolutely bound by "prudential limitations."

A philosophical difference has developed in the circuits. Some have engrafted unintended standing restrictions upon persons who file suit under RICO even though Congress intended RICO to be a remedial statute under which standing issues should be resolved in favor of the wronged as opposed to the wrongdoers. *Compare Haroco v. American National Bank & Trust Company of Chicago*, 747 F.2d 384 (1984), *aff'd*, 473 U.S. 606 (1985) *with Armco Industries Credit Corp. v. SLT Warehouse Co.*, 782 F.2d 475 (5th Cir. 1986) *and Rand v. Anaconda-Ericsson, Inc.*, 794 F.2d 843 (2nd Cir. 1983).

An analysis using fifth amendment multiple prosecution restrictions would be more appropriate in a RICO context than the "prudential limitation" invoked by the court of appeals. Each act which injures any plaintiff should be actionable by that plaintiff. The rights of a RICO plaintiff should not be contingent, as the Crockers' rights are under the decision of the court of appeals, upon

whether another party who has a potential claim decides to pursue that claim. There is no policy reason to protect wrongdoers—RICO defendants—who have committed criminal acts from multiple prosecutions. The policy considerations announced in *Sedima S.P.R.L. v. Imrex Co.*, 473 U.S. 479 (1985) indicate that the analysis under the fifth amendment for multiple criminal prosecutions, *see, e.g., Garrett v. United States*, 471 U.S. 773 (1985), *Blockburger v. United States*, 284 U.S. 299 (1932), are appropriate in a RICO situation, not the "prudential" limitation employed by the court of appeals in this case.

CONCLUSION

Jurisdiction under RICO should be the same in all fifty states. Any person injured in his property by reason of violation of 18 U.S.C. § 1961 *et seq.* should have standing without reference to the law of the state where the loss was sustained.

Respectfully submitted,

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APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 86-4546

OTTIS B. CROCKER, JR., *et al.*,
Plaintiffs-Appellees

VS.

FEDERAL DEPOSIT INSURANCE CORPORATION,
Intervenor-Appellant

VS.

W. P. MCMULLAN, *et al.*,
Defendants

Appeal from the United States District Court
for the Southern District of Mississippi

OPINION

(Filed on September 2, 1987)

Before JOLLY, HIGGINBOTHAM, and DAVIS, Cicuit Judges.

E. GRADY JOLLY, Circuit Judge:

In an attempt to bypass the general principles of standing in derivative actions that usually bar individual shareholder suits, a class described as "minority shareholders" filed this nonderivative action against a bank's

"controlling shareholders," on the theory that the minority had suffered individual harm not suffered by the corporation. Their theory has failed, and the derivative blockade has prevailed over the minority's hard-fought efforts to break through.

I

On May 11, 1984, the Mississippi State Commissioner of Banking closed the Mississippi Bank ("the Bank") pursuant to Miss. Code Ann. § 81-9-5 (1972). The Bank was adjudicated insolvent in state court, and FDIC was appointed receiver.

FDIC and Grenada Bank ("Grenada") entered a purchase assumption agreement in which Grenada assumed certain of the Bank's liabilities and purchased part of the Bank's assets. FDIC, in its corporate capacity, purchased all the Bank's remaining assets.[1]

On August 13, 1984, certain shareholders ("the Crockers") filed a nonderivative lawsuit on behalf of a class of minority shareholders, in which the Crockers were included, seeking damages from the former directors and/or officers of the Bank, who were also the controlling or majority shareholders. The complaint alleged (1) violations of the Racketeer Influenced and Corrupt Organization Act ("RICO"), 18 U.S.C. §§ 1961-1968; (2) common law misrepresentation to the minority shareholders regarding the Bank's financial condition; and (3) common law breach of a fiduciary duty to the minority shareholders on the part of the directors, officers and control-

[1] Specifically, FDIC, the corporation, purchased all contracts, rights, claims, demands and choses in action not purchased by Grenada; all loans subject to an option in favor of Grenada; and all pending claims, actions or judgments, known or unknown, that the receiver (FDIC) owned, held, or had against any surety, insurer or other person including, without limitations, claims against any director, officer or employee arising out of acts to the Bank or its property by virtue of the nonperformance or manner of performance of their duties or against any shareholder or holding company of the Bank.

ling shareholders. Federal jurisdication was based on the RICO claim.

The district court granted FDIC's motion to intervene, and FDIC moved to dismiss the Crockers' complaint under Fed.R.Civ.P. 12(b)(6). FDIC argued that the Crockers lacked standing because their claims were derivative and belonged to the corporation, not to the minority shareholders in their individual capacities. Alternatively, FDIC moved to stay the complaint under the "absolute priority rule." The district court denied FDIC's motions, holding that the Crockers, as minority shareholders, had alleged an individual injury that was sufficient to create a nonderivative cause of action. Following certification of the district court's order pursuant to Fed. R.Civ.P. 54(b), FDIC appealed.

II

Because federal jurisdiction in this case is predicated on the Crockers' RICO claim, we begin by examining the alleged RICO violation in Count I of the complaint. In Count I, the Crockers primarily allege that the defendants pursued a scheme to defraud the minority shareholders by mailing false, inaccurate and misleading financial statements and reports in order to lull "the minority shareholders of [the Bank] into a false sense of security and to postpone inquiries or complaints concerning the operation of the Bank." More specifically, the complaint alleges that the defendants' actions are indictable as two or more acts of mail fraud, 18 U.S.C. § 1341, within a period of ten years constituting a pattern of racketeering activity within the meaning of 18 U.S.C. § 1961(5).[2]

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[2] The parties have not raised the issue whether the defendants' action constituted a pattern of racketeering activity. We nonetheless take this opportunity to question once again whether the occurrence of two or more instances of mail or wire fraud in connection with the same discrete offense is sufficient to form a pattern of racketeering activity under 18 U.S.C. §§ 1961(5),

Count I further states that the Bank is an enterprise engaged in interstate commerce within the meaning of 18 U.S.C. § 1961(4); the defendants were employed by or associated with the Bank as required by 18 U.S.C. § 1962(c); and the defendants conspired to violate 18 U.S.C. §§ 1962(b) and (d). Finally, the Crockers contend in Count I: "Plaintiffs and the Plaintiff class have been injured in their property by reason of the aforesaid RICO violations by Defendants."

To withstand FDIC's motion to dismiss, the Crockers must allege in their complaint the "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 105 S.Ct. 3275, 3285, 87 L.Ed.2d 346 (1985). In addition, a standing requirement must be met: "the plaintiff only has standing if, and can only recover to the extent that, he has been injured in his business or property by the conduct constituting the violation." Id. at 3285-86. Thus, the issue in this case is whether the Crockers and the class of minority shareholders that they represent have suffered any individual injury to their property that is distinct from an injury to the corporation and therefore have standing to maintain a nonderivative RICO action. We hold that the Crockers lack standing and reverse the district court's denial of the motion to dismiss.

1962(c). *Compare R.A.G.S. Couture, Inc. v. Hyatt*, 774 F.2d 1350 (5th Cir. 1985) (multiple mailing in connection with a single sale is sufficient for a "pattern"), with *Montesano v. Seafirst Commercial Corp.*, 818 F.2d 423 (5th Cir. 1987) (criticizing *R.A.G.S.*) and *Smoky Greenhaw Cotton Co. v. Merrill Lynch, Pierce*, 785 F.2d 1274, 1280 n.7 (5th Cir. 1986) (questioning pre-Sedima definitions of "pattern"). Indeed, it is unclear in this case whether multiple mailings occurred or whether there was but one "mailing of a letter from [the Bank] to its shareholders" on March 15, 1984. Complaint, paragraph 26. We need not attempt to clarify this allegation since we dispose of this case on other grounds.

A.

State law determines whether a shareholder may maintain a nonderivative action. We must therefore review Mississippi law to determine whether the Crockers have standing to bring this action individually.

Mississippi adheres to the general rule that an action to redress injuries to a corporation cannot be maintained by a shareholder individually but must be brought as a derivative action in the name of the corporation. *Vickers v. First Mississippi National Bank*, 458 So.2d 1055 (Miss. 1984); *Bruno v. Southeastern Services, Inc.*, 385 So.2d 620 (Miss. 1980).[3] Mississippi courts have also

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[3] In *Bruno v. Southeastern Services*, the sole shareholder of a corporation brought a nonderivative action alleging that the defendant breached a contract to provide equity financing for the corporation. The plaintiff sought damages "for the destruction of the value of his stock in the corporation," 385 So.2d at 621. The Mississippi Supreme Court affirmed the defendant's demurrer holding that a shareholder, and even a corporation's sole shareholder, may not bring an individual cause of action to redress a wrong to the corporation, such as destruction or depreciation in the value of the shareholder's stock. Quoting *Schaffer v. Universal Rundle Corp.*, 397 F.2d 893 (5th Cir. 1968), the court noted, however, an exception to this rule: "The rule does not apply in a case where the stockholder shows a violation of duty owed directly to him." *Bruno*, 385 So.2d at 622.

The Mississippi Supreme Court applied the exception to the general rule in *Vickers v. First Mississippi National Bank*, 458 So.2d 1055 (Miss. 1984). In *Vickers*, the court permitted the sole shareholder in a corporation to sue a bank individually for the bank's failure to provide interim financing to the corporation. The court stressed that the bank's obligation to the corporation was predicated on the shareholder's contract with the bank and was owed to and enforceable by the shareholder individually. Id. at 1062. The Mississippi Supreme Court held that certain claims (those for damages from the lost corporate income, profits and investments and lost sums due to the IRS) were "Bruno-type claims" and that the plaintiff shareholder had no standing to assert these claims individually. With respect to these claims, the general rule applied: redress for damage to the corporation could only be

recognized that injury to shareholders in the form of a diminution in the value of stock is a loss that is recoverable only by the corporation in a direct action or by the shareholders in a derivative action. *Bruno*, 385 So.2d at 621; see also *Stevens v. Lowder*, 643 F.2d 1078, 1080 (5th Cir. 1981).

Acknowledging Mississippi's adoption of the general rule articulated in *Vickers* and *Bruno*, the district court held, however, that the Crocker's claim fit within the widely recognized exception to this rule; that is, a shareholder may maintain a nonderivative action for the violation of a duty owed directly to the shareholder as an individual. *Empire Life Ins. Co. v. Valdak Corp.*, 468 F.2d 330, 335 (5th Cir. 1972); *Vickers*, 458 So.2d at 1063. The district court reasoned that because the Crockers alleged "that the controlling majority shareholders injured the . . . minority shareholders, by their mismanagement and false and misleading financial statements," the Crocker's complaint stated an individual cause of action. *Crocker v. McMullan*, 623 F.Supp. 963, 968 (D.C. Miss. 1985).

FDIC argues that the district court erred because the minority shareholders suffered only a diminution in the value of their shares, a loss that, under Mississippi law,

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sought in a stockholder's derivative suit. Id. at 1062. However, claims predicated on the shareholder's own contract with the bank were distinguishable and could be asserted in a nonderivative action. The Court explained:

> What—and all—Bruno holds, however, is that a promisee plaintiff has no standing to sue and recover from a promisor where all damages claimed were in fact sustained by the corporation beneficiary and where the losses incurred by the promisee where [sic] wholly derivative from the losses to the corporation. . . . Put another way, to the extent that a shareholder may under our law bring a derivative action, he has no standing to sue in his own name.

Id. at 1063.

is recoverable only by the corporation in a direct action or by the shareholders in a derivative action. *Bruno*, 385 So.2d at 621; *Stevens*, 643 F.2d at 1080. FDIC further contends that in a RICO claim, or any other federal statutory action, a plaintiff has no standing if the alleged injury is based on a diminution in the value of the stock. *Gaff v. FDIC*, 814 F.2d 311 (6th Cir. 1987); *Rand v. Anaconda-Ericsson, Inc.*, 794 F.2d 843 (2d Cir. 1986); *Warren v. Manufacturers National Bank of Detroit*, 759 F.2d 542 (6th Cir. 1985).

The parties do not dispute that under Mississippi law a shareholder does not have standing to bring a direct cause of action when the only damage alleged is a diminution in the value of corporate shares. The Crockers contend, rather, that the injury they incurred is not solely the diminished value of their stock. They argue that the controlling shareholders pursued a scheme to defraud the minority shareholders by misrepresenting as sound the financial condition of the Bank. The misrepresentations artificially inflated the price per share of the Bank stock and, at the same time, lulled the minority shareholders into not selling their stock. The controlling shareholders were then able to sell their personal shares for an undeserved profit, while effectively denying the minority shareholders such an opportunity to sell their stock. For want of a better term, the Crockers' alleged injury is best described as a "lost profit opportunity." [4]

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[4] We note that the Crockers' "lost profit opportunity" theory of the alleged injury was presented in their briefs and at oral argument; it is not set forth as such on the face of the complaint. The complaint states in pertinent part:

> 23. Defendants caused and/or approved and/or acquiesced in preparation of various financial statements and reports which were false, inaccurate, and/or misleading . . .
>
> 26. Defendants caused the results of the Touche Ross & Company Report to be kept from the shareholders of [The Mississippi Bank] or approved and/or acquiesced in such, until March 15, 1984, at which time Defendants caused and/or

B.

Despite the Crockers' attempt to distinguish their injury from the classic model of diminution in the value of corporate stock, the end result was that all shareholders, as well as the Bank, lost the entire value of the stock. Essentially, the Crockers argue that the class of minority shareholders would have sold their stock on an indefinite date, at an artificially inflated (yet, unspecified) price, thereby realizing a profit (or at least minimizing their loss), if only they had known the true financial condition of the Bank.[5] They do not contend that the

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approved and/or acquiesced in the mailing of a letter from [The Mississippi Bank] to its shareholders enclosing such.

27. Defendants caused and/or approved and/or acquiesced in the language of the March 15, 1984 letter, which, coupled with an enclosed unaudited statement of condition of [The Mississippi Bank] dated February 29, 1984, glossed over the extent of its financial problems.

. . .

29. Because of the aforesaid actions of Defendants, [The Mississippi Bank] failed in May 1984, *rendering [The Mississippi Bank] stock of Plaintiffs and the Plaintiff class worthless* . . . (emphasis added).

In Count I of the complaint, the alleged RICO violation, the plaintiffs allege injury in their property by reason of the defendants' RICO violations, but do not specify how they were injured. However, in paragraph 44 of Count II and again in paragraph 49 of Count III the complaint states: "Plaintiffs and the Plaintiff class have been damaged to the extent of the *loss in market value of their stock in [The Mississippi Bank]*" (emphasis added).

Although it is certinly arguable that, on its face, the complaint alleges only diminished stock value, an injury insufficient to justify the plaintiffs' nonderivative action, we will assume that the complaint meets the minimal requirements for notice pleading in Fed. R. Civ. P. 8 and alleges the theory of injury.

[5] While we in no way purport to impose the purchaser-seller standing requirements, i.e., the *Birnbaum* rule, established for Rule 10b-5 securities actions on the Crockers' claim (which, of course, was predicated on mail fraud and not fraud in the sale

class or any member thereof desired specifically to sell their stock at a given point, but were deterred from effectuating a sale because of the misrepresentations. The

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of securities), we nonetheless find it instructive to note that in *Blue Chip Stamps v. Manor Drug Store*, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975), the Supreme Court warned of the dangers involved in granting standing to a class of nonpurchaser plaintiffs, similar to the class now before us, who assert such a speculative claim:

> Three principal classes of potential plaintiffs are presently barred by the *Birnbaum* rule. First are potential purchasers of shares . . . who allege that they decided not to purchase because of an unduly gloomy representation or the omission of favorable material which made the issuer appear to be a less favorable investment vehicle than it actually was. *Second are actual shareholders in the issuer who allege that they decided not to sell their shares because of an unduly rosy representation or a failure to disclose unfavorable material.* Third are shareholders, creditors, and perhaps others related to an issuer who suffered loss in the value of their investment due to corporate or insider activities in connection with the purchase or sale of securities which violate Rule 10b-5. It has been held that shareholder members of the second and third of these classes may frequently be able to circumvent the *Birnbaum* limitation through bringing a derivative action on behalf of the corporate issuer if the latter is itself a purchaser or seller of securities. . . .
>
> . . .
>
> The virtue of the *Birnbaum* rule . . . is that it limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates. . . . In the absence of the *Birnbaum* doctrine, bystanders to the securities marketing process could await developments on the sidelines without risk, claiming that inaccuracies in disclosure caused nonselling in a falling market and that unduly pessimistic predictions by the issuer followed by a rising market caused them to allow retrospectively gold opportunities to pass.
>
> . . . . In *Ultramares Corp. v. Touche* . . . Chief Judge Cardozo observed with respect to "a liability in an indeterminate amount for an indeterminate time to an indeterminate class":

claim is only that if they had known that the Bank was failing, they would have made every effort to rid themselves of the stock. We find this claim too speculative to state any injury to the shareholders, apart from a diminution in the value of their stock. It is our view that the alleged "lost profit opportunity" was, in reality, no profit opportunity at all. The flaw in the Crocker's argument is that it assumes a market for the stock existed at an artificially high price. This inflated price, and hence the particular market for the stock, was maintained only because of the wrongdoing of the Bank's controlling shareholders, who concealed material financial information from the shareholders and the public that would have demonstrated the failing condition of the Bank.[6]

It follows that, had this information been released, the stock price would have immediately and precipitously fallen especially if, as is implicit in the Crocker's theory, an entire class of shareholders had simultaneously dumped their stock on the market. Thus, there would have been no market for the stock at the artificially high price. Without such a market, the Crockers' envisioned "profit opportunity" evaporates into hardly more than an illu-

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"The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences."

421 U.S. at 737-48, 95 S.Ct. at 1926-31 (emphasis added, citations omitted).

[6] It is uncertain whether the Crockers' argument takes into account the fact that the controlling shareholders concealed materials information to which the public was equally entitled. If the Crockers had received this information and sold their stock for a profit before the public was made aware of the Bank's failing condition, such a profit would have resulted from insider trading in violation of the securities laws. It is too much to ask the court to recognize an injury based on a lost profit to which no one was lawfully entitled.

sion.[7] We cannot help but observe the troublesome paradox presented by the Crockers' theory: on the one hand, they claim the defendants' scheme caused their injury; yet, on the other hand, without the scheme, the minority shareholders could never have realized the artificially high profit that they claim to have unjustly lost. In sum, the Crockers complain that the scheme that harmed the minority shareholders also presented a unique profit opportunity, which the plaintiff class unfortunately missed.[8]

In any event, on this theory, the Crockers cannot plead injury sufficient to confer standing under RICO.

Finally, as we have previously stated, whether this action is derivative or not is governed by Mississippi state law. However, the district court, citing case law from other jurisdictions, seems to recognize a nonderivative cause of action based upon an injury that the controlling majority shareholders had inflicted on the minority shareholders. *Crocker*, 623 F.Supp. at 968. Not

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[7] We wish to emphasize that our legal analysis of the injury to the minority shareholders for purposes of standing under RICO is not meant to belittle the very real economic harm that the Bank shareholders have suffered. Although there can be no doubt that the harm inflicted has been financially devastating to certain shareholders, we are constrained in our legal analysis by the plaintiffs' claim as presented in the complaint before us. It is on this basis that we must conclude that, as a matter of law, the plaintiff shareholders have failed to plead the kind of individual injury required to survive the FDIC's motion to dismiss this RICO claim.

[8] The Crockers do not allege in their pleadings or briefs how the class intended to dispose of its stock. Any contention, however, that it would have sold the stock in a manner other than by public trading, is highly speculative because there is no averment that an identifiable buyer or group of buyers was prepared to purchase the class's stock. In such a scenario, it becomes even more speculative to suggest that the class suffered an identifiable injury; that is, that all shareholders except the controlling shareholders, would have banded together in a group or even subgroups to dispose of their stock in a block or blocks to unknown individuals or groups.

surprisingly, the only injury to the Crockers that the district court articulated in its opinion was a diminution in the Bank's stock value:

> As a result of the alleged misconduct by Defendants, *Plaintiffs' stock was rendered worthless.* This, the courts have found, is sufficient to constitute an individual cause of action. *See, e.g., Davis v. United States*, 451 F.2d 659, 662 (3d Cir. 1971); *Traylor v. Marine Corporation*, 328 F.Supp. at 384; *Yanow v. Teal Industries*, 422 A.2d at 322.

Id. (emphasis added).[9]

We have already noted that Mississippi courts generally do not permit a plaintiff to bring a nonderivative action if the only injury alleged is the diminution in stock value. For this reason, the district court erred in applying the relevant Mississippi case law.

We therefore must reject the reasoning of the district court and conclude that because the only injury the Crockers have effectively alleged is a decline in the value of the Bank stock, they have failed to state a direct, per-

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[9] Reviewing the precedent cited by the district court, we find that the Third Circuit's holding in *Davis v. United States Gypsum Co.* is not contrary to the general rule regarding derivative actions that we must apply in this case; that is, a shareholder's individual losses, such as liability on notes the shareholder has personally guaranteed, may be brought nonderivatively. However, a shareholder must file a derivative action for losses belonging to the corporation, such as diminution in stock value. 459 F.2d at 662. While the remaining case law cited by the district court might be interpreted to recognize, in those jurisdictions, a nonderivative cause of action on behalf of the minority against the controlling shareholders where special factors existed, this is not useful precedent to the resolution to this case. In the light of the Mississippi Supreme Court's holdings in *Bruno* and *Vickers*, only a derivative action will lie if the sole injury is diminution in the stock value. Indeed, the Crockers concede as much and have therefore attempted (unsuccessfully) to distinguish their injury from mere loss of stock value.

sonal injury distinct from that suffered by the corporation that would permit them to maintain an individual cause of action. We thus hold that the Crockers, alleging no cognizable individual injury, do not have standing to assert their RICO claim in a nonderivative action.

III

Because the Crockers lacked standing to assert their RICO claim nonderivatively, the claim upon which they predicated federal jurisdiction, the district court should have declined to exercise its pendent jurisdiction over the remaining state law claims and should have dismissed the complaint. *United Mine Workers v. Gibbs*, 383 U.S. 715, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966); *Slaughter v. Allstate Ins. Co.*, 803 F.2d 857 (5th Cir. 1986). We therefore do not address the remaining issues raised in this appeal.

IV

In conclusion, the district court erred by denying FDIC's motion to dismiss the Crockers' complaint. We therefore reverse and remand to the district court to enter a judgment dismissing the complaint.

REVERSED and REMANDED.

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF MISSISSIPPI
JACKSON DIVISION

Civ.A.No. J84-0603(B).

OTTIS B. CROCKER, JR., *et al.*,
Plaintiffs

and

FEDERAL DEPOSIT INSURANCE CORPORATION,
IN ITS CORPORATE CAPACITY,
Plaintiff/Intervenor

vs.

W. P. MCMULLAN, *et al.*,
Defendants

MEMORANDUM OPINION AND ORDER
(December 4, 1985)

BARBOUR, District Judge.

This matter is before the Court on the Motion of Plaintiff/Intervenor, Federal Deposit Insurance Corporation ("FDIC"), in its corporate capacity, to Dismiss the Complaint filed by Plaintiffs, Ottis B. Crocker, et al. ("Crocker"), and Plaintiffs' as yet uncertified class of all minority shareholders of the Mississippi Bank ("TMB"), for lack of standing to pursue their claims against Defendants, W. P. McMullan, Jr., et al., as majority shareholders, directors and officers of the now-defunct The Mississippi Bank.

FACTS

Prior to May 11, 1984, TMB was a banking institution organized and existing under the laws of the State of Mississippi. On May 11, 1984, the Commissioner of Banking and Consumer Finance of the State of Mississippi closed TMB pursuant to Miss. Code Ann. § 81-9-5 (1972). Immediately upon closing, the Commissioner petitioned the Chancery of the First Judicial District of Hinds County, Mississippi, for an adjudication of TMB's insolvency and for the appointment of FDIC as receiver of TMB. On May 11, 1984, TMB was adjudicated insolvent and FDIC was appointed receiver.

Thereafter, FDIC accepted appointment as receiver of TMB and took control of the assets and affairs of TMB. FDIC, as receiver, then entered into a purchase and assumption agreement with Grenada Bank whereby Grenada Bank assumed certain liabilities and purchased certain assets from FDIC as receiver. The FDIC, as receiver, also entered into the contract of sale with the FDIC in its corporate capacity whereby the corporation purchased all assets not purchased by the Grenada Bank pursuant to the purchase and assumption agreement. Specifically, the FDIC, in its corporate capacity, purchased all contracts, rights, claims, demands and choses in action whatsoever not purchased by Grenada Bank; all loans subject to an option in favor of the Grenada Bank; and all pending claims, actions or judgments, whether known or unknown, which the receiver owned, held, or had against any surety, insurer or other person or persons including, without limitation, any claim against any director, officer or employee arising out of any act or acts of any such person in respect to TMB or its property by virtue of the non-performance or manner of performance of their duties or against any shareholder or holding company of TMB.

On August 13, 1984, Plaintiffs, minority shareholders of TMB, filed suit for themselves and on behalf of a class

of minority shareholders in TMB, for damages against certain former directors and/or officers of TMB who were the controlling, or majority, shareholders of TMB. The Plaintiffs' Complaint asserts three separate claims. Count I alleges a violation by Defendants of the Racketeer Influenced and Corrupt Organization Act ("RICO"), 18 U.S.C. § 1961, *et seq.* Count II asserts a claim based upon various misrepresentations to Plaintiffs as to the financial condition of TMB. Count III is based upon violations by Defendants of fiduciary duties owed as directors and/or officers and controlling shareholders of TMB to TMB minority shareholders.

FDIC moves to dismiss the Plaintiffs' Complaint on the basis that Plaintiffs lack standing to prosecute their claims since both claims are derivative in nature and belong to the FDIC, in its corporate capacity, pursuant to the contract of sale. Alternatively, FDIC moves to stay Plaintiffs' Complaint on the basis that the FDIC is entitled to preferential recovery from Defendants under the "absolute priority rule."

LAW

1. *Non-Derivative Versus Derivative.*

As a general rule, an action to redress injuries to a corporation, whether arising out of contract or tort, cannot be maintained by a shareholder in his own name but must be brought in the corporate name because the cause of action belongs to the corporation and not the shareholders whose rights are merely derivative. *Warren v. Manufacturers National Bank of Detroit*, 759 F.2d 542, 544 (6th Cir.1985); *Schaffer v. Universal Rundle Corporation*, 397 F.2d 893, 896 (5th Cir.1968); *Vickers v. First Mississippi National Bank*, 458 So.2d 1055, 1061 (Miss. 1984); *Bruno v. Southeastern Services, Inc.*, 385 So.2d 620, 622 (Miss. 1980). According to *Empire Life*

Insurance Company of America v. Valdak Corporation, 468 F.2d 330, 335 (5th Cir.1972),

> [t]he reason for this rule is that each shareholder suffers relatively in proportion to the number of shares he owns and each will be made whole if the corporation obtains compensation or restitution from the wrongdoer. If each shareholder could sue individually for his losses, the wrongdoer would be subject to "as many suits . . . as there were stockholders in the corporation."

Consequently, a shareholder cannot maintain suit in his own name for injuries which affect the corporation as a whole or all its shareholders. *See, e.g., Stevens v. Lowder*, 643 F.2d 1078 (5th Cir.1981); *Gregory v. Mitchell*, 634 F.2d 199 (5th Cir.1981); *Imperial Motors, Inc. v. Chrysler Corporation*, 559 F.Supp. 1312 (D.Mass.1983); *Stirling v. Chemical Bank*, 382 F.Supp. 1146 (S.D.N.Y.1974).

A well-recognized exception to the general rule exists where the injury complained of creates not only a cause of action in favor of the corporation but also a cause of action in favor of a shareholder, as an individual, for violation of a duty owed directly to him. *Empire Life, supra.* at 335. Where the injury to the shareholder's stock is peculiar to him and does not fall alike on other shareholders, the shareholder may maintain an individual action. *Id.* As one court explained,

> [a] derivative suit is brought to enforce a cause of action which the corporation itself possesses against some third party, a suit to recompense the corporation for injuries which it suffered as a result of the acts of third parties. . . . A stockholder's individual suit, on the other hand, is a suit to enforce a right against the corporation which the stockholder possosses as an individual. *Smith v. Tele-Communication, Inc.*, 134 Cal.App.3d 338, 184 Cal.Rptr. 571, 573 (1982).

Moreover, the wrong necessary to support an individual action by a minority shareholder need not be unique to that shareholder, but may be shared in common by other minority shareholders. *Jones v. H. F. Ahmanson & Co.*, 1 Cal.3d 93, 81 Cal.Rptr. 592, 460 P.2d 464, 471 (1969).

This Court, applying Mississippi law,[1] concludes that the claims asserted by Plaintiffs, as minority shareholders, against Defendants, as majority shareholders and directors and/or officers, state individual causes of action. Plaintiffs' suit is clearly not an application for recovery by the corporation or all its shareholders. Damages are sought only on behalf of minority shareholders.

Moreover, the FDIC's contract of sale does not preclude the Plaintiff's maintenance of this suit. Under the contract of sale, the FDIC, in its corporate capacity, purchased

> "all contracts, rights, claims, demands, and choses in action whatsoever not purchased by the Assuming Bank (Grenada Bank) . . . and all pending claims, actions or judgments, whether known or unknown, *which the receiver owns*, holds or has against any surety, insurer, or any person or persons whomsoever including, without being limited to, any claim or claims against its directors, officers, or employees arising out of any act or acts of such persons in repsect to the Bank or its property, by virtue of the non-performance or manner of performance of their duties or against any shareholder or holding company of the bank."

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[1] State law determines who has suffered the injury and whether or not an action is, in reality, a shareholder's derivative action. *Gadd v. Pearson*, 351 F.Supp. 895, 900 (M.D.Fla. 1972). Mississippi adheres to the rule stated above. *Vickers v. First Mississippi National Bank*, 458 So.2d 1055 (Miss. 1984); *Bruno v. Southeastern Services, Inc.*, 385 So.2d 620 (Miss. 1980).

The FDIC, as receiver, took control of the assets and affairs of TMB. The FDIC, in its corporate capacity, purchased only corporate claims belonging to the receiver—not individual claims belonging to minority shareholders.

Further, the authorities cited by the FDIC are inapposite. None involved a situation analogous to the one sub judice where minority shareholders sued majority shareholders for misrepresentation, breach of fiduciary duty, and for RICO violations.[2]

In *Yanow v. Teal Industries*, 178 Conn. 262 422 A.2d 311 (1979), the plaintiff, a minority shareholder, brought an individual action and a shareholder's derivative action against the defendant corporation and its director and officer, claiming that the defendants had committed a series of corporate wrongs resulting in damages to the plaintiff individually and to the corporation. Specifically, the plaintiff alleged that the defendant engaged in nineteen transactions which were not disclosed to him and which had the effect of dismantling the corporation "step-by-step, transaction-by-transaction," depriving the corporation and the plaintiff of income and assets. Id. at 322.

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[2] FDIC relies on *Warren v. Manufacturers National Bank*, 759 F.2d 542 (6th Cir. 1985); *Gallagher v. Cannon U.S.A., Inc.*, 588 F.Supp. 108 (N.D.Ill. 1984) and *Club Assistance Program, Inc. v. Zukerman*, 594 F.Supp. 341 (N.D.Ill. 1984), for the proposition that Plaintiffs' RICO claim against the majority shareholders, directors and/or officers of TMB is a derivative cause of action, belonging only to TMB. However, these cases do not preclude a shareholder with an individual claim from pursuing a RICO violation. These cases only hold that the plaintiffs failed to establish a personal, non-derivative cause of action. *Gallagher* specifically recognized that a shareholder can assert RICO violations if it can show injury in its own right. The Court, on the FDIC's Motion to Dismiss, cannot, at this time, declare that Plaintiffs can prove no set of facts which would entitle them to relief under RICO.

The court held that plaintiff's claims were individual and not derivative. In so ruling, the court stated that the plaintiff's

> . . . allegations claim a pervasive breach of the fiduciary duty owed by the corporate majority to the sole minority stockholder. . . . [T]hese causes of action are based upon alleged unlawful acts relating solely to the stock owned by the plaintiff, in violation of the fiduciary duty owed the plaintiff by the defendants, and they thus state individual, and not derivative, claims. [citations omitted].

Id. See also, Jones v. H.F. Ahmanson & Company, 1 Cal.3d 93, 81 Cal.Rptr. 592, 460 P.2d 464 (Cal.1969).

In *Traylor v. Marine Corporation*, 328 F.Supp. 382 (E.D.Wis.1971), plaintiffs, minority shareholders, sued for damages for the wrongful disposition of corporate assets. The court rejected the contention that the complaint sounded in the nature of a shareholder's derivative action and stated

> [m]y reading of the complaint leads me to the conclusion that it may not be treated as a stockholder's derivative action. While accounting and restitution are sought in connection with the alleged improprieties, it is clearly not an application for recovery by the corporation or all its shareholders; damages are sought only on behalf of the minority shareholders. . . .
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> * * * *
>
> While the conduct described by plaintiffs may have warranted a derivative action on behalf of the corporation, that does not foreclose these plaintiffs from suing in their own right. . . . Thus, the plaintiffs could have said "You cheated the corporation"; however, they are also entitled to charge "*You cheated us as minority stockholders.*"

Id. at 384. [Emphasis added].

Plaintiffs claim that between 1982 and 1984, Defendants, as controlling shareholders, directors and/or officers engaged in a course of mismanagement which resulted in the ruination of TMB. Plaintiffs claim that Defendants prepared false and misleading financial statements and withheld the results of a 1984 Bank audit which would have revealed a net loss of $15,433,721 and a negative net worth of $499,545. According to Plaintiffs, Defendants finally mailed a letter from TMB to its shareholders which enclosed an unaudited statement of conditions and which glossed over the true financial condition of the Bank.

In Count I, Plaintiffs claim Defendants committed RICO violations by mailing false financial statements and by withholding the 1984 audit. Plaintiffs allege that these acts were a part of a common plan or conspiracy designed to defraud minority shareholders and delay inquiry into the operation of TMB which was being operated solely for the economic benefit of majority shareholders. Plaintiffs maintain that Defendants' conduct constitutes "racketeering activity" and that they were injured in their property by such activity.

Count II asserts a claim for misrepresentation based on the release of false and misleading financial statements which Plaintiffs claim they relied upon in retaining their stock and in taking no action regarding the management or financial condition of TMB.

Count III alleges a claim for breach of fiduciary duty owed by Defendants as controlling shareholders, directors and/or officers to minority shareholders.

This Court cannot state, on FDIC's Motion to Dismiss, that these claims are not personal to Plaintiffs, as minority shareholders. Taking all allegations of Plaintiffs' Complaint as true, as we are required to do on a motion to dismiss, the Court is not prepared to find, at this time, that it appears beyond all doubt that Plaintiffs can prove

no set of facts which would entitle them to the relief requested. A review of the Complaint reveals that the gravamen of the Plaintiff's Complaint does not allege an injury to TMB or all of its shareholders. Instead, Plaintiffs allege that particular shareholders profited and other shareholders were wronged. *See, e.g., Traylor v. Marine Corporation*, 328 F.Supp. at 384. Specifically, Plaintiffs allege that the controlling majority shareholders injured the Plaintiffs, as minority shareholders, by their mismanagement and false and misleading financial statements. As a result of the alleged misconduct by Defendants, Plaintiffs' stock was rendered worthless. This, the courts have found, is sufficient to constitute an individual cause of action. *See, e.g., Davis v. United States*, 451 F.2d 659, 662 (3rd Cir. 1971); *Traylor v. Marine Corporation*, 328 F.Supp. at 384; *Yanow v. Teal Industries*, 422 A.2d at 322. As Plaintiffs note, where majority shareholders are the wrongdoers, a derivative action is not an effective remedy because the wrongdoers—the majority shareholders—would be the beneficiaries of any recovery obtained by a derivative action. Accordingly, the FDIC's Motion to Dismiss is denied.

In light of this Court's holding that Plaintiffs are entitled to maintain this action individually, we now consider FDIC's alternate Motion to Stay this proceedings based on the "absolute priority rule" which allows general creditors of a corporation to recover against corporate assets before shareholders. In support of its Motion, FDIC relies upon *FDIC v. American Bank Trust Shares*, 412 F.Supp. 320 (D.S.C.1976), *vacated on other grounds*, 558 F.2d 711 (4th Cir. 1977), *on remand*, 460 F.Supp. 549 (1978), *aff'd. on other grounds*, 629 F.2d 951 (1980) (ABTS).

FDIC's Motion to Stay is denied for two reasons. First, ABTS involved derivative claims against the officers, directors and employers of the bank. 460 F.Supp.

at 551. Since Plaintiffs' action is non-derivative, ABTS is not applicable.

Second, Plaintiffs seek damages against the majority shareholders, directors and/or officers—not against TMB. Consequently, the absolute priority rule, which seeks to preserve corporate assets for the benefit of general creditors, does not come into play here where corporate assets are not involved. Accordingly, FDIC's Motion to Stay is denied.